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Office of Internal Audit

Louisville Metro

"Bogus" Suppliers



Report

Louisville Metro

Employee - Supplier Address Review

"Bogus" Suppliers

August 2006

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Transmittal Letter

August 7, 2006

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Re: Audit for "Bogus" Suppliers

Introduction

An audit of Louisville Metro's suppliers was performed. The objective of the review was to obtain assurance as to the legitimacy of suppliers paid by Louisville Metro. The focus was determining if any "bogus" suppliers, controlled by Louisville Metro employees, exist. Internal Auditing best practices for fraud detection recommend periodic reviews of employees and suppliers addresses.

Scope

The review used computer assisted auditing tools to compare supplier addresses in the LeAP financial system with employee addresses in the PeopleSoft human resources system. The data obtained for analysis consisted of approximately 24,300 supplier addresses and 7,020 employee addresses. Several computer assisted auditing tools were used in reviewing the data, which resulted in 142 sets of addresses identified for further review. These were reviewed by examining transactions and activities within both systems, as well as obtaining source documentation (e.g., payment documents) when necessary.

It is important to note that this review provides reasonable, not absolute, assurance that "bogus" suppliers, controlled by Metro employees, do not exist. The data analyzed is only as reliable as the information within the applicable systems. The computer assisted audit tools would not identify other types of fraudulent activity involving employees and suppliers. Other types of fraud detection reviews can be performed that focus on suppliers, such as dollar activity, invoice numbers, use of post office boxes, and multiple suppliers with the same address.

The examination was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

Conclusion

There were no "bogus" suppliers identified in the activity for the 142 sets of addresses identified for further review. The suppliers, and associated payment activity, appeared to have a legitimate business purpose. This provides reasonable assurance that "bogus" suppliers, controlled by Metro employees, do not exist.

Sincerely,



Michael S. Norman, CIA, CGAP
Chief Audit Executive

cc: Louisville Metro Council Audit Committee
Louisville Metro Council Members
Deputy Mayors
Secretary of the Cabinet for Finance and Administration
Chief Financial Officer

Background

Internal auditing best practices for fraud detection recommend reviews of employee and supplier addresses, focusing on matching addresses. This is founded on the risk that one way employees can defraud their organizations is through the accounts payable function. The theory is that employees could establish suppliers and process fake invoices, without detection, if internal controls are not effective. This could occur where segregation of duties is not adequate, monitoring or reconciliation of activity is not performed, or where there is collusion among employees.

This was a scheduled integrity audit. It is part of the Office of Internal Audit's focus on offering proactive, value-added services to Louisville Metro Government. It is not done in reaction to any situations involving Louisville Metro employees or suppliers, or indication that the applicable internal controls are not functioning as intended.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Office of Internal Audit previously audited employee and supplier addresses in 1998 (for the former City of Louisville). This was prior to the implementation of the current financial and human resource systems. Therefore, any prior audit issues are not relevant.

III. Statement of Auditing Standards

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

A formal study of the internal control structure was not conducted during this review.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

The examination did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the examination that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Results section of this report.

VI. Views of Responsible Officials / Action Plan

No actions are necessary at this time.

Observations and Recommendations

Scope and Methodology

An understanding of the procedures for establishing suppliers in Louisville Metro's financial system was obtained through interviews with key personnel. The focus was the procedures and controls that ensure legitimacy of suppliers. The purpose was to gain an understanding of the procedures only, not to evaluate the effectiveness of the internal control structure.

The data analyzed consisted of all active suppliers in the LeAP system as of May 8, 2006. Employees established in the system as suppliers were excluded from the review, as were suppliers with "Do Not Mail" as their address. The remaining data consisted of all employees in the PeopleSoft system as of May 10, 2006. This included employees whose status was active, on leave (with and without pay), or suspended. It did not include employees who no longer work for Metro, or inactive addresses for current employees. Assistance from Metro Information Technology and Metro Finance was required to obtain the data.

Computer assisted audit tools were used to review the supplier and employee data. The focus was identifying suppliers with addresses that were the same as employees. The data obtained for analysis consisted of approximately 24,300 suppliers and 7,020 employees. From these, 142 sets of addresses were identified for further review to determine if they were legitimate entities doing business with Louisville Metro. These were reviewed by examining transactions and activities within both systems, as well as obtaining source documentation (e.g., payment documents) when necessary. The results are as follows.

#1 – Results

No "bogus" suppliers were identified in the activity for the 142 sets of addresses identified for further review. The payment activity appeared to have a legitimate business purpose. The results of review are as follows (the total number exceeds 142 because some addresses had multiple employees).

- Seventy-five addresses were reviewed using a variety of methods, including LeAP, PeopleSoft, and sampling of payment documents. All appeared to be legitimate suppliers doing business with Metro. This conclusion relies on the effectiveness of the controls within LeAP that do not allow employees in one department to process transactions and charge them to another department (without approval / detection).
- Sixty-nine addresses were identified as not being a true employee – supplier match. Reasons for these include the following:

- The employee was set up in LeAP as a supplier instead of an employee. This is not a “bogus” supplier.
- The employee / supplier names were the same but the first / last name order was reversed. This indicates it was the same individual and not a “bogus” supplier.
- The match was not complete. For example, it could be the same street number and name but a different City / State / Zip Code. One of the limitations of the software used is that multiple address fields cannot be included for match identification (i.e. it is limited to two fields).

Recommendations

No recommendations are needed at this time.